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In the Supreme Court
of the United States

OCTOBER TERM 1956

No. 1010

ANGELA MacEVOY WOODLAW, OTIS O. JAMES and STEPHEN W. MATTHIEU, Executors of the Estate of G. T. Woodlaw, Deceased,

Petitioners,

vs.

HUGH H. EARLE, Former Collector of Internal Revenue for the District of Oregon,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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INDEX

	Page
Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit	1
Opinions Below	2
Basis of Jurisdiction	2
Questions Presented	2
Rule and Statute Involved	3
Statement of the Case	5
Reasons for Granting the Writ	7
Conclusion	12
Appendix A	13
Opinion of the Court	13
Dissenting Opinion of Judge Fee	41
Appendix B	43

AUTHORITIES

Page

CASES

Anderson v. United States, 218 F.2d 780 8

Clawans v. Whiteford, 55 F.2d 1037, 60 App. D. C. 412 9

C.I.R. v. Sullivan, 210 F.2d 607 11

Flanagan v. Helvering, 116 F.2d 937 11

Hargraves v. Bowden, 217 F.2d 839 8

In re Hargrove, 96 F.2d 168 8

Hirsch v. C.I.R., 124 F.2d 24 11

Keefe v. Cote, 213 F.2d 651 ..... 10, 11

Zimmerman v. Emmons, 225 F.2d 97, cert. den., 349 U.S. 906, rehearing den., 350 U.S. 855 8

STATUTES

Internal Revenue Code of 1939, Section 115(g) 3, 4, 5, 11

26 USCA § 302 12

28 USC § 1254(1) 2

28 USCA § 2071 8

RULES

Rule 17, Paragraph 6, Rules of the United States Court of Appeals for the Ninth Circuit, 28 USCA, United States Court of Appeals Rules, p. 480 3-4

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner prays that a Writ of Certiorari Issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled case on the 28th day of February, 1957, and confirmed upon re-hearing upon the 10th day of April, 1957, reversing the judgment of the District Court of the United States for the District of Oregon rendered upon the 26th day of September, 1955.

OPINIONS BELOW

The District Court did not render an opinion. The opinion of the Court of Appeals (R. 133), dated February 28, 1957, is reported at ....., and is appended hereto as Appendix A. Petition for re-hearing was denied without opinion on April 10, 1957.

BASIS OF JURISDICTION

The opinion and judgment of the United States Court of Appeals for the Ninth Circuit were filed February 28, 1957; petition for re-hearing was timely filed by the petitioner, and an order denying the petition for re-hearing was filed April 10, 1957.

Application for stay of mandate pending the application for writ of certiorari in this court was made April 15, 1957, and an order staying the mandate of the Court of Appeals for the Ninth Circuit until May 20, 1957, pending the application for writ of certiorari in this court was entered April 18, 1957.

Jurisdiction of this court is invoked under Title 28, United States Code, Section 1254 (1).

QUESTIONS PRESENTED

1. May a Court of Appeals, in violation of its own Rules which expressly set forth what portions of the record the court will consider, in deciding what is admittedly a question of fact (R. 136), consider portions of the record not appropriate for its consideration under its Rules without notice to the parties, and rely upon

such portions of the record in rendering its decision? May a Court of Appeals, when its violation of its Rules in the above regard has been pointed out to it by a petition for rehearing timely filed, deny a petition for rehearing and refuse to give the party adversely affected by its decision an opportunity to be heard upon the matters which the party was precluded from discussing in its brief by the Rules of the court?

2. May a Court of Appeals, by weighing the evidence, and applying the criteria which have been set forth in various decisions as grounds for affirming the decision of the trier of fact, reverse the factual determination of a District Court that payments made by a corporation to its sole stockholder in connection with the purchase and retirement of one-half of its stock were not distributions equivalent to a taxable dividend within the means of Section 115 (g) of the Internal Revenue Code of 1939?

RULE AND STATUTE INVOLVED

Rule 17, Paragraph 6, of the Rules of the United States Court of Appeals for the Ninth Circuit (28 USCA, United States Court of Appeals Rules, p. 480, provides:

> "In all cases, including those on petition for review to enforce or to set aside an order of a United States Board or Commission, the appellant or petitioner, upon the filing of the record in this court, shall file with the clerk a concise statement of the points on which he intends to rely. With such statement the appellant or petitioner shall file a designation of all of the record which is material to the

consideration of the appeal or review and forthwith serve on the adverse party a copy of the statement and designation. The adverse party, within 10 days thereafter, may designate in writing, filed with the clerk, additional parts of the record which he thinks material; and if he shall not do so, he shall be held to have consented to a hearing on the parts designated. *If parts of the record shall be so designated by one or both of the parties, or if such parts be distinctly designated by stipulation of counsel for the respective parties, the clerk shall print those parts only; and the court will consider nothing but those parts of the record and the points so stated.* If at the hearing it shall appear that any material part of the record has not been printed, the appeal may be dismissed, or such other order made as the circumstances may appear to the court to require. If the appellee shall have caused unnecessary parts of the record to be printed, such order as to costs may be made as the court shall think proper.

"All statements and stipulations filed hereunder shall distinctly and accurately refer to the pages of the original certified record as well as the documents to be printed or omitted." (Emphasis supplied.)

Section 115 (g) of the Internal Revenue Code of 1939 provides:

"If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend."

Other relevant portions of Section 115 of the Internal Revenue Code of 1939 are set forth in Appendix B hereto.

STATEMENT OF THE CASE

This is an action by the executors of the Estate of G. T. Woodlaw, deceased, for the refund of personal income tax paid by the estate after deficiencies had been duly assessed by the Collector of Internal Revenue. The action was tried before the Honorable Claude McColloch, District Judge. It was stipulated in the pretrial order that the only issue of fact to be determined was whether or not the transactions of the decedent with a corporation of which he was the sole stockholder were equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g) of the Internal Revenue Code (R. 34-35). The District Court found that the transactions in question were not transactions equivalent to the distribution of a taxable dividend within the meaning of that Section, but that the net effect of the distribution to the decedent was a distribution of capital assets (R. 50).

Respondent, the former Collector of Internal Revenue for the District of Oregon, appealed to the United States Court of Appeals for the Ninth Circuit. In connection with this appeal, and in accordance with the Rules of that court, the parties to the appeal designated certain portions of the record to be printed. These designations are made a part of the Record in this Court. The matter was duly argued, and subsequently, a majority of the Court of Appeals consisting of Circuit

Judge Stanley Barnes and District Judge William D. Murray rendered an opinion reversing the judgment of the District Court, and ordering judgment in favor of the "Commissioner" (R. 153)*, except as to a matter which is not relevant to this proceeding. The Court of Appeals examined the facts revealed by the record in considerable detail, including lengthy discussion of and frequent reference to exhibits not designated for printing in the Court of Appeals, and concluded that the decision of the trial court on the facts was clearly erroneous.

Circuit Judge James Alger Fee dissented, on the ground that factual issues only were presented, and that the trial court's findings should be accepted.

Thereafter, the petitioners herein duly filed their petition for rehearing, pointing out that the opinion of the court relied heavily upon exhibits which its Rules precluded it from considering, and asking the court for an opportunity to be heard upon the items of evidence which the Rules of the court had expressly precluded them from analyzing, explaining or considering. This petition was denied, without opinion. Judge Fee dissented.

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*Presumably referring to the respondent former Collector of Internal Revenue.

REASONS FOR GRANTING THE WRIT

The Violation by a Court of Appeals of Its Own Rules in Considering Matters Which the Parties Were Entitled to Assume Were Not Before the Court, Presents an Important Question of Federal Law Which Should Be Determined by This Court.

So far as petitioners have been able to discover, the question presented by this point is unique. The appellate court, no doubt inadvertently, in reviewing the decision of the trial court on a question of fact, considered evidence which, although in the record, had not been deemed sufficiently relevant for designation by either of the parties and which its own Rules stated would not be considered by the court. The importance that was assigned to these items of evidence is evidenced by the opinion of the court, which frequently refers to the Will of G. T. Woodlaw (R. 137-138, 142-143, 146), which is not a part of the record printed for the court's consideration. At one point, the lack of intent of the decedent Woodlaw to liquidate the corporation, one of the questions at the heart of the case, is stated to be "best proved, first, by the provisions of his Will . . ." (R. 146). At another point, the increase in the value of the stock of the corporation is referred to as part of the "best *proof*" (italics in original) of the lack of a policy of contraction on the part of the corporation (R. 145). This item of evidence would likewise not have been considered by the court, had it followed its Rules.

Petitioners duly filed their petition for rehearing, pointing out to the court its departure from its Rules and respectfully requesting that the court decide, in ac-

cordance with its Rules, what order would be appropriate under the circumstances. They also requested the court, if it was deemed necessary to supplement the Record by the addition of various exhibits the court had considered, to give the petitioners an opportunity to reargue the case upon a Record the contents of which they knew before presenting their argument. This petition was denied without opinion. Judge Fee dissented from the denial of the petition.

Petitioners fully appreciate that the procedure adopted by the Court of Appeals above outlined presents no burning question of civil liberties. Nevertheless, we respectfully submit that the right of a party to litigation, with the United States Government or otherwise, to be advised of what material is in and what out of the Record which the Appellate Court will consider before reviewing and reversing a substantial judgment, is fundamental to the proper administration of justice and the due process of law.

Congress has given the Courts of Appeal the power to promulgate rules of procedure (28 U.S.C.A. §2071), which so long as not inconsistent with Acts of Congress have the force and effect of law. *In re Hargrove*, 96 F. 2d 168 (C.C.A. 5, 1938). The Ninth Circuit has quite properly not hesitated to deal summarily with litigants who failed to comply with its Rules. See, e.g., *Anderson v. United States*, 218 F. 2d 780 (C.A. 9, 1955); *Zimmerman v. Emmons*, 225 F.2d 97 (C.A. 9, 1955); certiorari denied, 349 U.S. 946, Pet. for rehearing denied, 350 U.S. 855; *Hargraves v. Bowden*, 217 F.2d 839 (C.A. 9, 1954).

Rules having the force of law should be binding upon the court as well as upon the litigants. *Clawans v. Whiteford*, 55 F.2d 1037, 1038, 60 App. D.C. 412 (1932). Certainly the parties to this appeal would properly have been subject to censure by the court had they attempted to argue in their briefs the very factual matters upon which the majority of the court relies in its opinion. Petitioners have never had an opportunity to discuss or explain the various factual considerations referred to by the majority of the court, because they were precluded from doing so by the court's own Rules.

It is, of course, not a serious matter that a court should have inadvertently departed from the record in deciding a case. Accidents can happen, even in the judicial process, What is serious, however, is that when the court's error was pointed out to it by a timely petition for rehearing, the petition was denied without opinion. The opportunity thereby given for the court to rectify its error, by either deciding the case on the record before it, or permitting the appellees to argue the case on the record which the court had considered, was ignored.

Just as a person accused of a crime has a right to know the evidence which is used against him, a litigant who has been successful in obtaining a judgment is entitled to know the record on which the validity of that judgment is to be determined. This petition should be granted and the occasion taken for this Court to declare that the Courts of Appeal are as much bound by their own rules as the litigants before them.

The Factual Determination by a District Court That a Particular Distribution Was Not Essentially Equivalent to a Dividend Should Not Be Re-examined by an Appellate Court Based Upon a Weighing of the Evidence and Application of the Criteria Which Have Been Used to Uphold Factual Findings.

The District Court, which heard the evidence, concluded that the distribution in question was not essentially equivalent to a dividend (R. 50). Fundamental to this determination was the court's factual finding that a legitimate corporate purpose underlay the distributions in question (R. 50). The Court of Appeals, on its own evaluation of the evidence, rejects this conclusion (R. 145-146), stating that the reasons were personal to the sole stockholder, and not the usual corporate considerations.

The Court of Appeals neglects to explain why the advanced age of the sole stockholder, with no successor in sight, was not a reasonable factor for the corporation to take into account in determining whether or not to liquidate. It is true that it is difficult, in a corporation wholly owned by one man, to distinguish between individual and corporate purposes, but this very difficulty furnishes all the more reason why the District Judge, familiar with local conditions, having observed the witnesses, and given by law the responsibility of determining this fact, is in a better position to arrive at a factual determination than a reviewing court.

In this regard, the opinion of the court is at direct variance with that of the First Circuit, in *Keefe v. Cote*, 213 F.2d 651, 657 (C.A. 1, 1954). In that case, the reviewing court, although recognizing the difficulty of dis-

tinguishing between corporate purposes and those of the sole stockholder, held that the question of whether there was a legitimate business purpose for the distribution was a proper issue for determination by the jury, and affirmed.

It would unduly lengthen this petition to set forth a factual discussion of the case. Many of the relevant facts are set forth in the opinion of the Court of Appeals. A mere reading of the opinion makes evident the manner in which that court appraised for itself the evidence in the case, and arrived at its own factual conclusions. In doing so, it applied various criteria which have been developed over the years by the courts in their consideration of Section 115(g) of the Internal Revenue Code of 1939. These criteria, however, have been applied as grounds for upholding factual determinations, and the court cites not one single case where a factual determination that a distribution was not essentially equivalent to a dividend was set aside as "clearly erroneous."

An important question of federal law is here presented. In making the factual determination, it has been held in numerous decisions that the test of the essential equivalence of a distribution to a dividend is the "net effect" of the distribution. *Keefe v. Cote*, 213 F.2d 651, 656 (C.A. 1, 1954); *C. I. R. v. Sullivan*, 210 F.2d 607, 609 (C.A. 5, 1954); *Hirsch v. C. I. R.*, 124 F.2d 24, 29 (C.C.A. 9, 1941); *Flanagan v. Helvering*, 116 F.2d 937, 939, 940 (C.A.A.C., 1940). Rather than permitting the District Court to determine, on all the evidence, what the net effect of the transaction was, the Court of Appeals now insists that certain specific criteria must be met. As Judge Fee stated (R. 22):

> "Here our colleagues seem to rely, not upon the record as a whole upon which the trial court based its judgment, but upon such remote analogies. Reliance is placed by them upon inferences drawn from the attitudes of other courts in a series of cases painstakingly accumulated by Judge Barnes which they feel command findings of fact contrary to those actually found by the District Court. *Such a process equates a conclusion drawn on a cold record from an aggregate of facts with a rule of law.*" (Emphasis supplied.)

It is significant that in all the litigation which has arisen from this section, and the numerous cases applying the various criteria discussed by the majority of the court, not one case is cited in which these criteria were used to reverse a trier of fact's factual determination upon the entire record.

We respectfully submit that the appellate court is not in a position to substitute its own judgment about the purposes of the transaction and the motives of the taxpayer for those of the trier of fact. This Court should reffirm the proposition that the determination of equivalence to a dividend under this provision, now 26 U.S.C.A. § 302, is a question of fact, to be decided upon the entire record.

CONCLUSION

For the foregoing reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

GEORGE W. MEAD,
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STEPHEN W. MATTHIEU,
Of Counsel.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

HUGH H. EARLE, Former Collector of Internal Revenue,
Appellant,
vs.
ANGELA MACEVOY WOODLAW, et al,
Appellees.

No. 15,062
Feb. 28, 1957

Appeal From the United States District Court for the District of Oregon

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Before: Fee and Barnes, Circuit Judges, and Murray, District Judge.

BARNES, Circuit Judge:

The District Collector of Internal Revenue for Oregon appeals from a judgment of the District Court awarding appellees (Executors of the estate of G. T. Woodlaw, deceased) the sum of $153,550.92 for the year 1946; $1,162.67 for the year 1947; and $31,688.38 for the year 1949, together with interest and costs, which sums constitute claims for refund of taxes paid because of deficiencies assessed against taxpayer—decedent, G. T. Woodlaw, for the years mentioned.

The deficiencies were claimed in each year because the Government asserted that certain payments made by the Oregon corporation, Woodlaw Investment Company, to the taxpayer G. T. Woodlaw as sole stock-

holder, (save for qualifying shares) in connection with the purchase and retirement of one-half of the corporation's outstanding stock, were distributions essentially equivalent to a taxable dividend, within the meaning of Section 115(g) of the Internal Revenue Code of 1939. The deficiencies had been paid with interest, and timely claims for refund subsequently filed.

Taxpayer and appellees had maintained the payments in question were a distribution of capital assets, and paid taxes on that basis. The trial court so found, (Finding XIX, Tr. 50) and as well, that there existed a legitimate business purpose for the sale of stock in 1946, and that Section 115(g) of the Revenue Act was inapplicable, (Finding XX, Tr. 50). Appellants urge there is no evidence in the record to support either of such Findings. (XIX and XX) and further, that the District Court erred in holding that a $40,225.15 debt, owned by G. T. Woodlaw to the corporation, and written off by the corporation as part of the claimed distribution, was not taxable as ordinary income.

Section 115 of the Internal Revenue Code of 1939 reads in part as follows:[1]

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[1]Other material portions of Section 115 are:

"(a) (as amended by Secs. 166 and 186(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798) Definition of Dividend.—The term 'dividend' when used in this chapter (except in section 201(c)(5), section 204(c)(11) and section 207(a)(2) and (b)(3) (where the reference is to dividends of insurance companies paid to policyholders) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (com-

"(c) (as amended by Sec. 147 of the Revenue Act of 1942 (supra) Distribution in Liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. the gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of sub-section (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * * * *

(g) Redemption of Stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribuion of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * * * * * *

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puted as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.*****

(b) Source of Distributions.—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits.*****"

(i) Definition of Partial Liquidation.—As used in this section the term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

* * * * * * *

(26 U.S.C. 1952 ed., Sec. 115.)[2]

As both sides must, and do, recognize.

"the question of whether a particular corporate distribution is a liquidating dividend within the meaning of Section 115(c), or is essentially equivalent to an ordinary dividend within the purview of Section 115(g) is a question of fact and depends upon the circumstances of each case." (Appellant's Brief, p. 13.)

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[2]Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

"Sec. 29.115-9. Distribution in Redemption or Cancellation or Stock Taxable as a Dividend.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all

> "Each case under this section of the code must be determined upon its own facts." (Appellee's Brief, p. 25.)

And, they agree, the ultimate conclusion reached by the trial court on such a factual question can be reversed only when "clearly erroneous."

We first note that Findings of Fact XIX and XX are, by their terms, in part combined Findings of Fact and Conclusions of Law. That the transaction detailed in this case was "not a transaction equivalent to the distribution of a taxable dividend within the meaning of Section 115(g) of the Internal Revenue Code" and that "the net effect of the distribution to the said G. T. Woodlaw was a distribution of capital assets" are at best combined findings of fact and conclusions of law, if not purely conclusions of law. (Cf. *Thornley v. C.I.R.*, 147 F.2d 416.) The same must be said of the last part of Finding XX; that "there was in existence . . . in 1946

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of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. If a distribution is made pursuant to a corporate resolution reciting that the distribution is made in liquidation of the corporation, and the corporation is completely liquidated and dissolved within one year after the distribution, the distribution will not be considered essentially equivalent to the distribution of a taxable dividend; in all other cases the facts and circumstances should be reported to the Commissioner for his determination whether the distribution, or any part thereof, is essentially equivalent to the distribution of a taxable dividend."

. . . a legitimate business purpose" for the sale of the stock by G. T. Woodlaw to the corporation, "and Section 115(g) of the Revenue Act is inapplicable."

This last finding raises the inference that the District Court found that Section 115(g) of the Revenue Act was inapplicable *because* it found that there was a legitimate business purpose for the distributions. If this inference be that it was the legitimate business purpose *of the corporation*, and not of Woodlaw personally, we can find no support for it in the evidence.

Section 115(g) is not a complicated law vis a vis the facts of this case. Here there was a cancellation or redemption[3] of one-half of its outstanding stock by the Woodlaw Investment Company.[4]

Was the redemption "at such time, and in such manner" as to make it in whole or in part essentially equivalent to the distribution of a taxable dividend? If so, to the extent it represents a distribution of earnings or profits accumulated after February 28, 1913, the law requires that it be treated as a taxable dividend.

What facts did the District Court have before it, which this court must consider in coming to its conclu-

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[3]We make no distinction between stock cancelled and retired; and stock redeemed but held by the corporation as unissued stock. (*Boyle v. C.I.R.*, (3 Cir.) 187 F.2d 557, cert. den. 342 U.S. 817.)

[4]We will, throughout this opinion omit reference to the qualifying shares, and consider G. T. Woodlaw to have been the holder of all outstanding stock, both before and after the redemption in question. (Cf. *Christopher v. Burnett*, (D.C.Cir.) 55 F.2d 527; *Hirsch v. Commissioner*, (9 Cir.) 124 F.2d 24.)

sion as to whether the trial court's findings of fact are clearly erroneous?

In this case, the record is short, (forty-six pages of oral testimony) and the facts relatively simple. Colonel G. T. Woodlaw had died before the trial. His widow, his lawyer, and five business associates testified on behalf of his estate.

The Colonel was a rugged individualist, with forceful ideas, and strong convictions. A man of "dominant disposition,"—"He handled his own affairs and fought his own battles." His Will, in evidence, (Defendant' Ex. 1) proves that well. In 1946, when the purchase by the corporation of one-half of Colonel Woodlaw's stock took place, he was eighty years of age. He had been shaken by the death, in an airplane accident on November 29th, 1945, of his grandson, Graham Castel Woodlaw, the Colonel's adopted son, and his "heir-apparent." The Colonel believed "the sun rose and set in him." (Tr. 116.) The youth's death without question left Colonel Woodlaw a heart-broken old man.

Mr. Gamble, the first witness, had purchased the stock of the Circle Theatre Company, a corporation, from Colonel Woodlaw, as of May 5, 1947. This Company *operated* the Circle Theatre, *renting* from the Woodlaw Investment Company, who held title to the theatre building. In the contract of purchase, the Gambles, (for Mrs. Gamble also signed the contract) were assured that the seller, Colonel Woodlaw, would secure for them an eight year lease of the premises, at a rental of $300 per week, with an option to the Gambles for

another fifteen years, and a second option for a further ten year period. Thus, the Contract of Purchase (Plaintiff's Ex. 6) obligated the Woodlaw Investment Company, or its assignee, some number of years into the future, i.e. until 1979. The Gamble contract also provided that

> "any rentals that may hereafter accrue to the Circle Theatre Co. by reason of existing leases or as monthly rental from any portion of the Circle Theatre Bldg., other than the Theatre itself, shall be assigned . . . to the Woodlaw Investment Company, . . ."
>
> (Plaintiff's Ex. 12, p. 3)

Witness Gamble made his purchase of Circle Theatre stock from Colonel Woodlaw, not from the Woodlaw Investment Company. He made it after the date of purchase by the Company of one-half of the Colonel's stock. The Colonel discussed with Gamble, in 1947, his desire "to liquidate *his* assets", (Tr. 59) and get "*his* affairs in shape; that he had set up a considerable sum of cash in the United States National Bank and "wanted to proceed with it." (Tr. 60) This was "because of his age, and the fact he wanted to get his affairs in shape so his widow would have no difficulty if something happened to him." (Tr. 60)

> "Q. Did that (the proceeding with the liquidation of his affairs) include the physical property of the Woodlaw Investment Company, . . .?"
>
> "A. He didn't go into details with me . . ." (Tr. 60)

Likewise, the witness Riley had conversations with the Colonel in 1946 or '47 or '48, relative to "*his* holdings". (Tr. 63).

"I could not identify whether it was Woodlaw Investment Company or Colonel Woodlaw. It was his holdings, yes." (Tr. 63)

Witness Rogoway leased the Fourth Avenue Hotel, in 1946, from the Woodlaw Investment Company. The precise term of the lease is not in evidence, but after an extension had been given, it "expired Decembr 31, 1956." (Tr. 108)

In 1947, the same witness was offered the opportunity to purchase the Fourth Avenue Hotel property, the Circle Theatre and the Maguire Bldg. (Tr. 68) for one million dollars, "the stipulated figure." Rogoway "told some of his friends and associates," but "it amounted up to quite a sum of money." The Colonel thereafter discussed the possibility of liquidating right up to the time of his death. "He told me he had done his bit of work, and he was getting old, and he would like to kind of take a back seat for a while." (Tr. 69).

The witness Childs, when he heard the Colonel was interested in liquidating his assets, brought the Colonel together with a Mr. Caraplis, in 1948. The three had lunch at the Golden Pheasant, and "discussed the buildings, the revenue and the price."

"Q. Nothing ever came of that situation?"
"A. Not that I know of." (Tr. 73)

Mr. Matthieu, the Colonel's attorney, never knew of any negotiations with Caraplis, (Tr. 109); he knew of negotiations with Rogoway; he did not know of any other negotiations for sale of any properties with any other people. (Tr. 109, 110.) The property was not listed

for sale with any real estate firms, because, we may infer, of the Colonels antipathy toward them. (Tr. 110.)

Mr. Matthieu, the Colonel's attorney, testified the Colonel redrew his Will in December 1945, after the boy's death. (Tr. 82.) No testimony was introduced as to the contents of that Will. This witness testified to the following "steps" in the plan to liquidate the Woodlaw Investment Co.:

1. Sale of vacant lot in February 1946 for $2,200.

2. Sale of vacant Failing Street property in April 1946 for $9,000.

3. Sale of Hamilton Building, May 29th, 1946 for $80,000.

4. Sale of Circle Theatre stock, as of May 5, 1947. [It is difficult to see how the sale of this stock, of a separate corporation, was part of the *corporation's* plan to dispose of its holdings. It is obvious that the sale of the stock was part of the Colonel's plan to sell his holdings, (Cf. Tr. 107, 108) and escape managerial responsibility. The explanation proffered as to corporate benefit was that a long term leasehold made the fee attractive to possible buyers from the corporation. (Tr. 108.)]

Meanwhile, in October of 1945, *before the death of his son, and before any plan to liquidate the corporation,* the corporation had sold the Gerlinger Building.

"Q. When was that building sold?"

"A. That was October, 1945." (Tr. 104.)

(October 12, 1945; Pretrial Order, Para. XV; Tr. 33.)

"Q. When would you fix the time, Mr. Matthieu, that he formulated the plan of liquidating all of the assets of the Woodlaw Investment Company that have been described?"

"A. I would say in December of 1945."

The terms of the Gerlinger Building sale are undisclosed in the evidence. (Plaintiff's Ex. 12.)

Mrs. Woodlaw testified, briefly, that her husband "desired to unload". (Tr. 115.) In response to a leading question, she testified the Gerlinger Building sale, in 1945, was the result, of a conclusion

"that the corporation would not expand its activities, but would contract them."

She inferentially contradicted this testimony almost immediately by stating that it was the death of the grandson that gave Colonel Woodlaw the desire to contract the corporate activities.

She knew "what was going on", but nothing of any attempts to sell the principal properties, save the one contact with Mr. Caraplis, and the "negotiations" as testified to by Mr. Rogoway.

We next turn to the Exhibits in evidence. Plaintiff's Exhibit 5, the Hamilton Building "sale", is worthy of comment.

The price was $80,000, payable $10,000 down and the balance payable in monthly installments of $518.00 per month,

"which monthly installments shall include interest at the rate of 4% per annum on the unpaid balance . . ."

By the agreement, title did not pass until payments were fully made, although the seller agreed it would pass title after the principal sum due had been decreased to $40,000 upon demand of purchaser.

Rough calculations indicate that a dozen years or so would be required before title could pass in any event, and more than that before the purchase price would be fully paid. This certainly is not the type of contract that one would usually find being entered into by a corporation planning an orderly liquidation of its assets. The minutes of the special meeting of the Directors, held on April 30, 1946, at which this agreement for sale was authorized, contain nothing to aid us in determining why it was to be made. (Plaintiff's Ex. 11.)

Another Exhibit deserves comment. Plaintiff's Exhibit 15 is a copy of the Minutes of the Special Joint Meeting of Stockholders and Directors of Woodlaw Investment Company, held February 9, 1946, to consider the retirement of 1400 shares of stock of the corporation. The minutes list those present. It was then:

> "Resolved, that the corporation purchase 1400 shares of the Woodlaw Investment Company stock at $190.00 per share, and this stock be retired by the Corporation; that the President, G. T. Woodlaw, be instructed to purchase these shares on behalf of the Corporation."

The meeting then adjourned. The minutes show no discussion of the matter; no reference to any plan of contraction; no reference to any general business conditions or factors which might influence the director's decision; no indication of why or how the figure of $190.00 per

share was arrived at;[5] no indication of any advantage to be gained by the corporation in taking this action.

Nothing contained in the Minutes of the January 25, 1946 meeting, (approving of the President's previous decision and contract to sell the Gerlinger Building) or the Minutes of February 5, 1946, (authorizing the officers to reduce the Capital Stock from 3500 shares of common to 2800 shares of common) gives any hint of why such actions were taken, nor what benefit could arise for the corporation, nor for that matter, for anyone else.

It is true that this undoubtedly was completely a one man corporation; that, as Mr. Matthieu testified:

> "When I say 'he' I mean the Woodlaw Investment Company in many instances."
> (Tr. 104)

Nevertheless, we still must seek to find a corporate purpose, rather than a shareholder's purpose.

It is easy to understand that the minutes may not have been kept as fully, or as accurately, as though minority stockholders or representatives of other interests existed, who might one day be concerned with their contents. They are mentioned to point out they add nothing to the appellee's position, and gave the trial judge no help in coming to the conclusion which he did, and which is here challenged.

Another document in evidence is the last Will and Testament of G. T. Woodlaw. (Defendant's Ex. 1.) It

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[5]The stock was appraised at the date of death at $360.71 per share; based on a total value of $504,994.00. Compare this with the "stipulated price" of $1,000,000 asked for its principal asset.

was dated December 30th, 1948. If the testator had any idea of dissolving the corporation in 1946, he must have given it up before he wrote his Will in 1948. (The Colonel had executed a new Will in December of 1945. It may or may not have aided the trier of fact here, but it was not introduced in evidence.) The 1948 Will read, (paragraph six) in part:

> "I believe I have my affairs in such order that my estate will have sufficient funds to pay such (inheritance) taxes without disposing of any of my stock in the Woodlaw Investment Company. However, if . . . my estate does not have sufficient funds to pay such taxes, then . . . I direct . . . my Executors to borrow from the Woodlaw Investment Company an amount sufficient (to pay taxes) and any amount so borrowed shall be paid back to said Woodlaw Investment Company in annual installments over the period of 15 years of the trust hereinafter set up, and at such interest rates as my executors and trustees may agree with the Woodlaw Investment Company."

The testator then created a fifteen year trust from the date of his death; (a) "of all the outstanding stock of the Woodlaw Investment Company"; plus (b) any indebtedness of the Woodlaw Investment Company owed to him ($97,000 when the Will was executed); plus (c) any sums left over, after inheritance taxes, from the $145,000 in Government bonds he held at the time of execution of the Will.

His Will provided for a division of the stock of Woodlaw Investment Company fifteen years after his death:

400 Shares to his son, Robert Thornton Woodlaw
701 " to his wife, Angela
115 " to charity
125 " to relatives
59 " to friends

The trustees were authorized to operate the Woodlaw Investment Company during the period of the trust.

Before we consider the law applicable to the facts of this instant case, we must first recognize that "most of the cases arising under Sec. 115(g) are of little value in the determination of the question instantly presented, for the reason that each depends for its solution upon its own peculiar facts." *McGuire v. Commissioner*, 7 Cir., 84 F.2d 431, 432; *Hirsch v. Commissioner*, 9 Cir., 124 F.2d 24; *Bazley v. C.I.R.*, 3 Cir., 155 F.2d 237; affirmed, 331 U.S. 737, 67 S.Ct. 1489, 91 L. Ed. 1783. "In determining whether a transaction is equivalent to a taxable dividend within Section 115 (g), or whether it is a partial liquidation under 115(c), neither the Board of Tax Appeals nor the courts have laid down a sole decisive test." *Flanagan v. Helvering*, D.C. Cir., 116 F.2d 937.

The cases do, however, lay down certain "judicial criteria," as Judge Vinson described them in the *Flanagan* case, which have proven useful in coming to a conclusion as to whether Sec. 115(g) is applicable. These are:

1. Did the corporation adopt any plan or policy of contraction of its business activities?

2. Did the corporation follow an orderly procedure looking toward its ultimate dissolution, or its ultimate contracted operation?

3. Did the initiative for the corporate distribution come from the corporation, based on usual business considerations, or did it come from stockholders, (or a stockholder), for their (or his) own purpose?

4. Is the proportionate ownership of stock by the shareholders changed?

5. What were the amounts, the frequency and the significance of dividends paid in the past?

6. Does the capitalization, at the time of cancellation of the stock, represent capital paid in, or earnings from the business?

7. Was there a sufficient accumulation of earned surplus to cover the distribution, or was it partly from capital?

8. Was there a maintenance of a relatively similar amount of capital liability, or did that figure decrease to a degree somewhat comparable to the purported distribution of capital?

9. Was there good faith, or bad, in the action of the Board of Directors?

10. What was the net effect of actions taken?
This last criteria is that of most importance.

We shall discuss each of these guide posts in turn.

I. Did the corporation adopt any plan or policy of contraction of its business activities?

Here there exists no satisfactory credible evidence that any plan or policy of contraction was ever adopted *by the corporation.* The usual *place* to find such a policy

expressed is in the corporate minutes. No such expression exists here. The best *proof* is in the conduct of the corporate affairs in the period subsequent to the alleged date of adoption of the plan. Here the corporation continues to operate, financially as healthy as ever, nine years after the claimed decision to contract. It continued to operate 90%, in value, of its properties. It increased the value of its shares between 1946 and the death of its chief stockholder from $190 to $360 per share.

The stock, valued at approximately one-half million for inheritance purposes, represented primarily the ownership of three apparently contiguous pieces of real property: the Fourth Avenue Hotel, the Circle Theatre and the Maguire Building. Feeble attempts were made to sell that property for a "stipulated" one million dollars. Sales of two unimproved parcels of realty produced $11,200. The Hamilton Building sale produced $10,000 cash and a $70,000 paper obligation extending over a long term. This is scant evidence of any real purpose to "contract" the corporate operations of Woodlaw Investment Company. We refer herein to evidence that indicates that such plan or policy, if it ever existed, did so for no substantial length of time.

II. Did the corporation follow an orderly procedure looking toward its ultimate dissolution, or its ultimate contracted operation?

The answer here is obviously that it did not; or at least no evidence thereof is before us. *Rheinstrom v. Conner*, 6 Cir., 125 F.2d 790, cert. den. 317 U.S. 654.

The corporation did continue to operate, and at a profit. *Flanagan v. Helvering*, supra.

III. Did the initiative for the corporate distribution come from the corporation, based on usual business considerations, or did it come from the stockholders, (or stockholder), for their, (or his), own purpose?

Here clearly, the cases which rest on plans for corporate reorganization, or corporate lack of capital, or excessive amounts of capital, are all beside the point. Here the sole stockholder was tired of his role as a business man; his tiredness was accentuated by the unexpected death of his adopted son. But these were *his* reasons for letting go the helm, not the usual corporate considerations.

If we are to assume that the unexpressed corporate intent or purpose can be inferred from the only stockholder's intent and purpose to "liquidate his holdings," whether in 1945, before his grandson's death, or in 1946 after it, or even in 1947 when the "one million dollar" proposition was discussed, certainly sometime before his second Will was drawn in 1948, he (Woodlaw) had no further intent to liquidate the Woodlaw Investment Company. That is best proved, first by the provisions of his Will, and more emphatically, by the fact "the Woodlaw Investment Company has continued in existence since 1946 in the same type of business from that date up to and including the present time." (October 18, 1955; Additional Finding of Fact, III; Tr. 129.)

IV. Is proportionate ownership of stock by shareholders changed ?

The answer is, of course, that it was not. The materiality of this factor is well expressed in many cases. See particularly, *Flanagan v. Helvering*, supra.

V. What were the amounts, the frequency, and the significance of dividends paid in the past?

Here the corporation paid dividends in but two years of its existence—1938 and 1939. (Additional Finding of Fact II; Tr. 128, 129.)

In 1938 it had operated at a loss. Starting in 1920 with a capital of $200,000, it increased that capital in 1923 to $250,000, and in 1929 to $350,000. (Plaintiff's Ex. 27.) It had in 1929 an "Earned Surplus and Undivided Profits" of $114,000. That surplus went up and down, but was $146,000 in 1939. It went up to $286,000 in 1945. Altho it was reduced by the $163,000 cash paid to Colonel Woodlaw in 1946, (and perhaps by the cancellation of his loan account of $40,000 in the same year), it had grown back to $270,000 in 1949. (Additional Finding, II.)

It seems obvious that the sole stockholder, for his own convenience, failed to have the corporation pay dividends during the long period of years when the corporation, "based on usual business considerations," would ordinarily have done so. This seems to meet the indicia discussed in *Commissioner v. Roberts*, 4 Cir., 203 F.2d 304, where there was a finding that there had been accumulations by the corporation for no definite corporate purpose, that there was on hand "a large and unnecessary accumulation of cash representing earnings." (*Commissioner v. Roberts*, supra, p. 306, 307.)

VI. Does the capitalization, at the time of the cancellation of the stock, represent capital paid in, or earnings?

There is no testimony as to where the funds came from to account for the two increases in capitalization in 1923 and 1929.

VII. Was there a sufficient amount of earned surplus to cover the distribution, or was it partly capital?

The record is clear on this issue, that the distribution was from accumulated net income classified as "Earned Surplus and Undivided Profits, on the books of the corporation." (Additional Finding of Fact II; Tr. 129.)

Where there was on hand undistributed surplus five times as large as par value of stock, and earnings in one year three times the amount distributed thru retirement, money paid was dividend subject to income taxes, under facts of case, despite the fact the entire class of preferred stock was retired. *Goldstein v. C.I.R.*, 7 Cir., 113 F.2d 363.

Where a corporation in good years increased capital by stock dividends, and reduced capital when capital requirements were reduced in subsequent years, distribution was not taxable as dividends. *Dana v. Sheehan*, 8 Cir. 163 F.2d 316.

Distributions by a corporation are taxable "dividends" only so far as derived from earnings and surplus, and are not taxable to the extent they represent a return of capital investment. *Jones v. Dawson*, 10 Cir., 148 F.2d 87.

VIII. Was there a maintenance of a relatively similar amount of capital liability, or did that figure decrease to a degree somewhat comparable to the purported distribution of capital?

Here there was decrease of capital liability from $350,000 to $280,000 on March 5, 1946.

But the significance of this decrease is small, in view of the continuing surplus, and its continued increase.

Where par value of shares was reduced one-half and capital was reduced one-half by payment to common stockholders, and there were sufficient earnings and profits accumulated by a bank over the years to cover the distribution, it was a "dividend" for income tax purposes, notwithstanding the fact that the bank did not declare a dividend; and had no intention to do so. *Dunton v. Clauson,* 67 Fed.Supp. 839.

A reduction of par value of stock by $2.00 per share, and distribution of reduction from surplus, without intent to wind up affairs or curtail business, was a taxable "dividend". *Wilcox v. C.I.R.*, 9 Cir., 137 F.2d 136. Cf. *Fostoria Glass Company v. Yoke,* 45 Fed.Supp. 962.

IX. Was there good faith, or bad, in the action of the Board of Directors?

The question of "good faith" was in earlier cases held important. It is now considered of such little importance that it is practically immaterial. In any event, we need not question the good faith in this case.

The question whether a distribution is "essentially equivalent to the distribution of a taxable dividend" does

not depend on presence or absence of honesty in distribution, but the question is one of equivalents, and, if that is present, distribution is taxable. *Stein v. United States*, 62 Fed.Supp. 568; 104 Ct.Cl. 446; *Hirsch v. C. I.R.*, supra; *Smith v. United States*, 3 Cir., 121 F.2d 692.

The good faith or lack of it, leading to the actions taken by the corporate officers is not, as the earlier cases enunciated it, controlling. *Hirsch v. Commissioner*, supra, at 30; refusing to follow; *Patty v. Helvering*, 2 Cir., 98 F.2d 717; and *Commissioner v. Quackenbos*, 2 Cir., 78 F.2d 156.

Some of the earlier cases, emphasizing that a question of fact is involved, also urge that the intent of the directors of the corporation is to be considered. *Tate v. Commissioner*, 8 Cir., 97 F.2d 658; *Tootle v. Commissioner*, 8 Cir., 58 F.2d 576. But later cases place the emphasis on the *effect* of the distribution as that which controls, and not the intent nor the motives, either of the taxpayer or the corporation. *Smith v. United States*, supra.

> "[T]he net effect of the distribution rather than the motives and plans of the taxpayer or his corporation is the fundamental question in administering Sec. 115(g)."
>
> *Flanagan v. Helvering*, supra.

This brings us to our last, and most important criteria.

X. What was the *net* effect of the actions taken?

If all purchases of its own stock by a corporation taken together, accomplish the same result as the declaration of a dividend, a gain derived by a stockholder

therefrom is taxable as a dividend. *Trust Company of Georgia v. United States*, 60 Fed.Supp. 470; 104 Ct.Cl. 150.

In *Hyman v. Helvering*, the petitioners owned 1998 shares of the 2000 shares outstanding. The earned surplus was approximately $100,000. Petitioner sold 1950 shares to the corporation for $195,000. Held, to the extent of the surplus, the purchase of stock was taxable as a dividend under Sec. 115(g). 28 B.T.A. 1231, D.C. Cir., 71 F.2d 342; cert. den. 293 U.S. 570.

This case describes the legislative history behind Sec. 115(g), at page 344.

> "Suppose . . . the case of two men hiding practically the entire stock of a corporation for which each paid $50,000. The corporation having accumulated a surplus of $50,000 above its cash capital, buys from the stockholders for cash one-half of the stock held by them, and cancels it, and the payment is non-taxable because it is a partial redemption of stock. To change this result and make it taxable Sec. 115(g) was written and incorporated into the law."

House, Senate and Conference Reports. H. Rep. No. 1, 69th Congress, First Session, p. 5; S. Rep. No. 52, 69th Congress, First Session, p. 15; H. Conf. Rep. No. 356, 69th Congress, First Session, p. 30.

In *Smith v. United States*, supra, the plaintiff formed a personal holding company in 1923, owning all shares, both common and preferred. By 1934, there was accumulated $240,000 in earnings. In that year the plaintiff transferred 880 of his preferred shares to the holding company in exchange for $49,500 in securities of other

companies. Later he transferred 435 shares of preferred for $43,500 in mortgages. In 1935 the plaintiff transferred to the corporation 425 shares of preferred for $42,500 cash. The court found (1) that "no justifiable business reason prompted the company's redemption of its stock"; (2) that the transfers were "accompliahed for the personal advantage and service of the plaintiff", (3) that plaintiff's own equity in the company remained what it had always been, 100%, and (4) that the company continued to operate as before.

> "The answer within the intendment of (g) turns not so much upon the question of whether there was or was not liquidation, as upon the result."
>
> P. 695.

The court affirmed that the transactions were taxable as dividends.

In *Boyle v. Commissioner of Internal Revenue*, 3 Cir., 187 F. 2d 557, the Tax Court held there was a *taxable dividend*, on the following facts:

1. "a corporation with three principal stockholders holding their shares in virtually equal proportions, distributed to themselves the bulk of its accumulated earnings: ultimately there remained three stockholders."
2. the company never paid cash dividends.
3. there was no policy of contraction or liquidation.
4. the initiative came from majority stockholders.
5. there was a large earned surplus, and
6. there was an unnecessary accumulation of cash.

Both the earned surplus and cash were reduced "as they would have been by the declaration of a true dividend." Held: Taxable dividend.

The reasons for the existence of Section 115(g) is well expressed in Mertens' Text.

> "The basic principle for the taxation of distributions in liquidation, complete or partial, is that they are treated as a sale or exchange, rather than as ordinary dividends, even though the liquidating distributions include earnings and profits. This has been true since the 1924 Act, and probably the 1918 and 1913 Acts."
>
> (Mertens, Vol. I, Sec. 9.77, p. 52, et seq.)
>
> "under the 1916, 1917 and 1921 Acts, the treatment was different: that portion of a distribution in liquidation which represented distribution of earnings or profits accumulated after February 29, 1913 was treated as ordinary dividend, the balance as a reduction of cost . . ."
>
> (Mertens Law of Federal Income Taxation, Vol 1, p. 528)

Practical problems were raised by the difference in treatment effected by the two viewpoints of the law makers. Total liquidation could not always be accomplished immediately, nor even under the three year and two year limitations of the Acts of 1938 and 1936. (Sec. 115(c)) This as Mertens says, "provoked considerable controversy," and necessitated partial liquidating dividends.

Prior to 1942, amounts received in partial liquidation of corporate assets were treated as short term capital gains. This was to prevent tax avoidance by distributing ordinary income in the guise of a partial liquidation. But this arbitrary distinction between non-taxable total liquidation and taxable partial liquidation, resulted in inequality in the case of unquestionably bona fide redemp-

tions of stock not equivalent in any way to the distribution of a taxable dividend. The Report of the Ways and Means Committee of the 77th Congress (Report No. 2333, 77th Congress, 2nd Session, P. 93) stated, relative to their proposed solution of the problem—the enactment of Sec. 115(g).

> "It is believed that the proper application of Section 115(g) will prove adequate to prevent taxable dividends disguised as liquidations from receiving capital-gains treatment."

Mertens' *Law* of Federal Income Taxation, Sec. 9.78, 1955-Cum. Pocket Supp., p. 403.

In view of the law and the facts of this case, we must find the decision of the lower court clearly erroneous.

We think the language used in the last paragraph of the *Roberts* case, (supra, p. 307) is particularly apt:

> "Any conclusion other than that which we have reached readily shows how easily the tactics of a taxpayer here could be used as a means of tax evasion. A prosperous corporation, for example, with a single stockholder, earns large sums of money, available for, and which should be paid out as dividends. This sole stockholder syphons off this money (as was done in the instant case) to himself by selling a portion of his stock to the corporation at a price per share which will just cover the earnings. Surely this is a redemption 'essentially equivalent to the distribution of a taxable dividend'. Congress must have had just such a situation in mind when it enacted section 115(g). . . . The decision of the Tax Court of the United States is reversed and the case is remanded with directions to enter a decision in favor of the Commissioner."

See also these cases, heretofore referred to:

Flanagan v. Helvering; Hirsch v. C.I.R.; Bazley v. C.I.R.; Rheinstrom v. Conner, particularly pages 792, 794.

This brings us to appellant's third point, that the debt of $40,225.15 owed by G. T. Woodlaw to the Woodlaw Investment Company and written off by the corporation in the transaction was not taxable as ordinary income to said G. T. Woodlaw in the year of distribution.

This point refers to Finding of Fact XXI which reads:

> "That part of the income attributable to the taxpayer arose out of the write-off of $40,225.15 shown due on the books of Woodlaw Investment Co. from decedent, G. T. Woodlaw."

We were inclined to believe this language might be ambiguous in the printed record before us, (Tr. 50). It raises a nice semantic question. If the first two words meant "that *part*", etc.; the sentence is complete; if it means "*That* part", the sentence is incomplete. We have checked the original document, and find the printed Transcript of Record correct. We therefore must interpret it as though the second word is emphasized. The semantic resolution creates substantive problems. It would seem to follow from the finding that the sum should be treated as ordinary income. Yet, the District Court's judgment indicates by implication that it was not so regarded.

Finding XVIII indicates that some decision had been made between the Government and the taxpayer, as to the non-taxability of this item of $40,225.15 many years ago. The Government had apparently determined the moneys lent to Colonel Woodlaw were not dividends realized by the taxpayer, *at that time*.

The ordinary rule has been expressed by this Circuit in the *Hirsch*, case, supra,

> "If the stockholder borrows money from the company and subsequently the company cancels the debt, income accrues to the stockholder at the time when the character of the withdrawals changes from a loan to a distribution of profits."

Quoting with approval, *Weise v. Commissioner*, 8 Cir., 93 F.2d 921, 922: Cf. *Allen v. Commissioner*, 1 Cir., 117 F.2d 364, 368.

In light of our position respecting this case and the uncertainy of the District Court's disposition of this particular item, we feel constrained to remand the case to the District Court so that it may determine, consistent with the views herein expressed: (a) what part, if any, of the $40,225.15, cancelled in 1946 by the corporation, is not taxable in any year or event as income; or (b) is not taxable in the year 1946 as the equivalent of a dividend, because taxable in some other year, and if so, what years. That is a matter we cannot determine upon the record presently before us.

The decision of the District Court is reversed and the case remanded for further proceedings on the $40,-225.15 item, in accordance with the aforesaid ruling of

this court. The decision is reversed, and judgment ordered in favor of the Commissioner, on all other items.

Reversed.

JAMES ALGER FEE, Circuit Judge, dissenting:

Since this case has been sent back for partial retrial, the grounds of the dissent should be set out. We should have affirmed the judgment of the trial court.

It is admitted that this is an appeal upon questions of fact. No legal principles are involved. This Court is not empowered to write new findings of fact. It can reverse when the findings are clearly erroneous only when, on the entire evidence, the reviewing court is left with a definite and firm conviction that a mistake has been made.

Therefore, we must be convinced from the record in the particular case that the mistake was made. Collateral considerations as to what some other trial court or any appellate court may have thought about some state of facts in a different case more or less remotely analogous are not proper for consideration.

Here our colleagues seem to rely, not on the record as a whole upon which the trial court based its judgment, but upon such remote analogies. Reliance is placed by them upon inferences drawn from the attitudes of other courts in a series of cases painstakingly accumulated by Judge Barnes which they feel command findings of fact contrary to those actually found by the District Court. Such a process equates a conclusion drawn

on a cold record from an aggregate of facts with a rule of law.

The knowledge of local customs of business and personalities of witnesses is present with the trial judge. We know the business methods of New York City might lead to entirely different findings than those of Oregon. The trial judge in the vicinity is alone capable of appreciating the subtleties of his own business community. We should not attempt to build up an empirical rule of law which would bind this vast circuit.

The findings of the trial judge, based as they were upon intent of Colonel Woodlaw, should be controlling. The judgment of the sole stockholder and active manager of the corporation as to what measures were best for it could well be accepted by the trial judge.

The judgment should be affirmed.

(Endorsed:) Opinion and Dissenting Opinion. Filed Feb. 28, 1957. Paul P. O'Brien, Clerk.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) [as amended by Secs. 166 and 186(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Dividend.*—The term "dividend" when used in this chapter (except in section 201 (c)(5), section 204 (c) (11) and section 207 (a)(2) and (b)(3) (where the reference is to dividends of insurance companies paid to policy holders)) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. * * *

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

(c) [as amended by Sec. 147 of the Revenue Act of 1942, *supra*] *Distribution in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts

distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provision of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * *

(l) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * *

(26 U.S.C. 1952 ed., Sec. 115.)

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and other authorities involved	2
Statement	2
Argument	5
Conclusion	10
Appendix	11

CITATIONS

Cases:	
Bazley v. *Commissioner*, 155 F. 2d 237, affirmed, 331 U. S. 737	6
Chandler's Estate v. *Commissioner*, 228 F. 2d 909	7
Commissioner v. *Roberts*, 203 F. 2d 304	7
Flanagan v. *Helvering*, 116 F. 2d 937	7
Keefe v. *Cote*, 213 F. 2d 651	6
Hormel v. *Helvering*, 312 U. S. 552	9
Smith v. *United States*, 121 F. 2d 602	7
Stein v. *United States*, 62 F. Supp. 568	7
United States v. *Breitling*, 20 How. 252	9
United States v. *Gypsum Co.*, 333 U. S. 364	8
Vesper Co. v. *Commissioner*, 131 F. 2d 200	7
Statute:	
Internal Revenue Code of 1939:	
Sec. 115 (a) (26 U. S. C. 1952 ed., Sec. 115 (a))	11
Sec. 115 (b) (26 U. S. C. 1952 ed., Sec. 115 (b))	11
Sec. 115 (c) (26 U. S. C. 1952 ed., Sec. 115 (c))	11
Sec. 115 (g) (26 U. S. C. 1952 ed., Sec. 115 (g))	6, 12
Sec. 115 (i) (26 U. S. C. 1952 ed., Sec. 115 (i))	12
Miscellaneous:	
Rules of the Court of Appeals for the Ninth Circuit:	
Rule 10	15
Rule 17	8, 15
S. Rep. No. 52, 69th Cong., 1st Sess., p. 15 (1939-1 Cum. Bull. (Part 2) 332, 344)	7, 14
Treasury Regulations 111, Sec. 29.115-9	7, 12

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 1010

ANGELA MACEVOY WOODLAW, OTIS G. JAMES AND STEPHEN W. MATTHIESU, EXECUTORS OF THE ESTATE OF G. T. WOODLAW, DECEASED, PETITIONERS

v.

HUGH H. EARLE, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF OREGON

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The District Court rendered no opinion.[1] The opinion of the Court of Appeals (Pet. 13–42) is not reported.

JURISDICTION

The judgment of the Court of Appeals was entered on February 28, 1957. (R. 155.) An order denying petition for rehearing was entered on April 10, 1957. (R. 156.) The petition for a writ of cer-

[1] The District Court's findings of fact and conclusions of law appear at R. 41–51, 128–129.

tiorari was filed on May 18, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether the Court of Appeals properly concluded that the payments here involved were corporate distributions equivalent to a taxable dividend within the meaning of Section 115 (g) of the Internal Revenue Code of 1939.

2. Whether the Court of Appeals erred in considering evidence which was part of the record on appeal but was not contained in the printed record.

STATUTE AND OTHER AUTHORITIES INVOLVED

The pertinent provisions of the statute and other authorities involved are Section 115 (a), (b), (c), (g) and (i) of the Internal Revenue Code of 1939; Section 29.115-9 of Treasury Regulations 111; S. Rep. No. 52, 69th Cong., 1st Sess., p. 15; and Rules 10 and 17 of the Rules of the United States Court of Appeals for the Ninth Circuit. They are set forth in the Appendix, *infra*, pp. 11–16.

STATEMENT

The pertinent facts as found by the District Court in its original findings of fact (R. 41–51) and in its additional findings of fact (R. 128–129) are as follows:

Petitioners here are the executors of the estate of G. T. Woodlaw, deceased. With the exception of qualifying shares, Woodlaw owned all of the stock of the Woodlaw Investment Company, an Oregon

Corporation organized on April 15, 1920. During 1946, Woodlaw sold 1,400 shares of his stock to this company and in reporting the sale on his 1946 income tax return treated the proceeds as a capital gain to the extent that such proceeds exceeded par value of the stock. (R. 44, 128.)

The consideration for the above sale was $266,000, which was paid by the company to Woodlaw in the following manner: (1) cash in the amount of $163,000 paid in 1946, in the amount of $2,000 paid in 1947 and in the amount of $370.90 paid in 1949; (2) settlement in 1946 of debts due from Woodlaw in the amount of $40,225.15 and carried in an open account for the years 1930, 1931, 1932, 1939, 1940, and 1944; and (3) transfer in 1949 of a contract receivable valued at $60,403.95. (R. 44–45, 48–49.) For items making up the sum of $40,225.15 owed by Woodlaw, see R. 46–47, 49.

The Woodlaw Investment Company kept its books and made its tax returns on the cash basis. It had substantial undistributed profits and its surplus account as shown on its 1946 return is as follows (R. 48):

Beginning Surplus		$286,985.99
Profit for year 1946		35,357.15
Total		322,343.14
Deduct Federal Income Tax Paid	$15,294.22	
Note Receivable Cancelled	1,000.00	
Income taxes 1946 (United States)	8,339.29	
Income taxes 1946 (State of Ore.)	3,215.07	27,848.58
Balance		294,494.56

For the years 1929 through 1949, the tax returns of Woodlaw Investment Company showed the following (R. 128–129):

Year	Net income	Earned surplus and Undivided profits	Dividends paid
1929		$114,013.22	
1930	$41,023.09	151,488.38	None
1931	23,889.86	170,294.38	None reported
1932	6,505.69	173,419.29	None
1933	9,708.71	191,030.47	None
1934	1,391.51	197,595.22	None
1935	(20,721.29)	159,683.77	None
1936	(1,910.12)	158,298.32	None
1937	5,149.90	164,022.89	None
1938	(14,905.29)	144,219.14	$5,241.60
1939	6,202.06	146,239.89	5,000.00
1940	10,330.00	156,351.67	None
1941	21,122.65	173,985.92	None
1942	26,902.84	195,495.91	None
1943	23,840.10	212,297.18	None
1944	31,867.68	229,551.12	None
1945	59,377.47	286,985.99	None
1946	35,357.15	180,043.92	None
1947	26,758.78	198,468.41	None
1948	30,730.73	222,651.98	None
1949	59,536.75	270,423.64	None

The Woodlaw Investment Company has been primarily engaged in the business of owning, leasing and renting of real estate in Portland, Oregon. (R. 48). It has not only continued in existence up to "the present time" but has also continued in the same type of business. (R. 129.)

On October 12, 1945, the Woodlaw Investment Company sold its Gerlinger Building and on May 29, 1946, its Hamilton Building. It also sold some undeveloped lots in 1946. (R. 48.)

On the basis of the foregoing facts, the District Court found (R. 50):

> That the transaction wherein G. T. Woodlaw, deceased, received in the year 1946, $163,000.00 for 1,400 shares of the capital stock of Woodlaw Investment Co. together with the additional sum of $2,000.00 in the year 1947 and

> a real estate sales contract in the year 1949 with a balance due of $60,403.95 with additional cash in that year in the amount of $370.90 was not a transaction equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g) of the Internal Revenue Code. The net effect of the distribution to the said G. T. Woodlaw was a distribution of capital assets.

The District Court further found (R. 50):

> That there was in existence at the time of the transaction in 1946 involving the sale of the stock by the decedent, G. T. Woodlaw, to Woodlaw Investment Co. a legitimate business purpose therefor and Section 115 (g) of the Revenue Act is inapplicable.

Upon the above findings, the District Court concluded that the petitioners here were entitled to recover deficiencies in income tax, with interest, which had been paid for the years 1946, 1947, and 1949. (R. 51.)

The Court of Appeals (Judge Fee dissenting) found the decision of the lower court clearly erroneous. (R. 151.) Accordingly, it reversed the decision but remanded the case for a clarification of the District Court's finding as to the debts cancelled in 1946. (R. 153.)

ARGUMENT

1. The Court of Appeals reversed the decision of the District Court because it concluded (R. 151) that, on "the law and facts of this case", the decision was clearly erroneous. It held that the payments involved here are equivalent to ordinary dividends and

are taxable under 1939 Code Section 115 (g) (Appendix, *infra*, p. 12), which provides that, if a corporation cancels its stock in such a manner as to make the distribution and cancellation in whole or in part essentially equivalent to a dividend, the amount so distributed shall be treated as a taxable dividend.

As the Court of Appeals pointed out (R. 136–137), the District Court's decision is based on its Findings XIX and XX (R. 50), which state (1) that the net effect of the payments was a distribution of capital assets, and (2) that there was in existence at the time of the sale of the stock by Woodlaw to the Woodlaw Investment Company a legitimate business purpose therefor.[3] The Court of Appeals correctly found that these ultimate findings (or conclusions) are wholly unsupported by evidence. The underlying facts are painstakingly recited in Judge Barnes' opinion below (Pet. 19–27) and, significantly, are not disputed in the petition (see Pet. 11). As the opinion further demonstrates (Pet. 27–38), in reaching a conclusion rested on these undisputed facts the court below applied the precise criteria which have been approved in many cases holding that payments under similar circumstances should be taxed as dividends under Section 115 (g). *Bazley* v. *Commissioner*, 155 F. 2d 237 (C. A. 3d), affirmed, 331 U. S.

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[3] Although this finding is ambiguous, we assume, *arguendo*, that it is intended to imply a business purpose on the part of the corporation, since it would certainly not aid petitioner to show that the corporation's purchase of the stock was made for reasons personally beneficial to the taxpayer-stockholder. *Smith* v. *United States*, *supra*; *Bazley* v. *Commissioner*, *supra*; see, also, *Keefe* v. *Cote*, 213 F. 2d 651, 657 (C. A. 1st).

737; *Chandler's Estate* v. *Commissioner*, 228 F. 2d 909 (C. A. 6th); *Commissioner* v. *Roberts*, 203 F. 2d 304 (C. A. 4th); *Smith* v. *United States*, 121 F. 2d 692 (C. A. 3d); *Flanagan* v. *Helvering*, 116 F. 2d 937 (C. A. D. C.); *Stein* v. *United States*, 62 F. Supp. 568 (C. Cls.); *Vesper Co.* v. *Commissioner*, 131 F. 2d 200 (C. A. 8th). Also, see Sec. 29.115–9 of Treasury Regulations 111 and S. Rep. No. 52, 69th Cong., 1st Sess., p. 15 (1939–1 Cum. Bull. (Part 2) 332, 344) (Appendix, *infra*, pp. 12–14).[4]

As to the alleged business purpose for the payments to Woodlaw, examination reveals that none of the District Court's findings (R. 41–51) explains what or whose business purpose it was, and none indicates that the Woodlaw Investment Company intended to liquidate or had any plans for contraction of its business. Nor is there anything in the corporate minutes (R. 100–101) on the subject of liquidation. Indeed, the minutes relative to the purchase of Woodlaw's stock in 1946 are entirely silent as to the purpose of such purchase or the resulting payments. Moreover, although Woodlaw's attorney and his widow showed by their testimony that they were well informed as to his business, neither indicated that the sale of stock

[4] Petitioner contends (Pet. 3, 12) that these criteria have been invoked, without exception, in cases in which the trial court's determination was sustained. This is not so, as *Commissioner* v. *Roberts*, *supra*, illustrates. In all events, it needs no argument that the criteria which are meaningful for purposes of determining the justifiability of an ultimate finding as to the nature of a transaction are also pertinent—and necessarily so—for purposes of determining whether such a finding is *un*justified.

was in any way connected with a purpose to liquidate holdings. (R. 78–83, 103–120.)

Additional facts which were affirmatively found by the District Court and are contrary to its conclusion that the payments were a distribution of capital assets include the following: (1) after the 1946 transaction, the Woodlaw Investment Company not only continued in existence, but engaged in the same type of business down to "the present time" (*i. e.*, October 18, 1955) (R. 129); (2) in the twenty-one years from 1929 through 1949, dividends were paid only in 1938 and 1939, although, during all of that period, the company had a large accumulation of earned surplus and undivided profits available for dividends, having enjoyed net income in every year except 1935, 1936, and 1938 (R. 129); and (3) after the sale and retirement of part of Woodlaw's stock in 1946, he still held the same proportion of the stock and as sole stockholder (except for qualifying shares) was still in control (R. 44). In view of these primary findings and the absence of subsidiary findings which would point in a contrary direction, the Court of Appeals was amply warranted in holding a "definite and firm conviction that a mistake has been committed." *United States* v. *Gypsum Co.*, 333 U. S. 364, 395.

2. Petitioner complains that the Court of Appeals considered evidence that was not included in the printed record, although it was, as petitioner concedes (Pet. 7), part of the record on appeal. It is urged that the court thus violated its own Rule 17 (Appendix, *infra*, pp. 15–16), which provides in sub-

stance that the court will only consider the printed portions of the record.

Such a rule is, of course, designed to impose upon counsel a burden of care in designating matter for printing. But since rules of practice have as their ultimate objects the promotion of justice and the facilitation of the business of the courts (*Hormel* v. *Helvering*, 312 U. S. 552, 557), it has never been doubted that a court may withhold a sanction which its rules would permit it to impose. *United States* v. *Breitling*, 20 How. 252, 254.

Here, there is no basis whatever for a claim of prejudice. The only items from the unprinted record to which the court referred were Woodlaw's Last Will and Testament written in 1948 (which contemplated the continued existence of the Woodlaw Investment Company, see Pet. 26) and evidence of the increased value of the remaining shares of Woodlaw Investment following the retirement of the 1,400 shares in 1946 (see Pet. 29). Far from introducing unsuspected elements into the processes of appellate deliberation, these items of evidence appearing in the unprinted record on appeal merely served to corroborate the primary findings of the District Court summarized above (p. 8).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JUNE 1957.

APPENDIX

Internal Revenue Code of 1939:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) [as amended by Sec. 166 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Dividend.*—The term "dividend" when used in this chapter (except in section 201 (c) (5), section 204 (c) (11) and section 207 (a) (2) and (b) (3) (where the reference is to dividends of insurance companies paid to policy holders)) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

(c) [as amended by Sec. 147 of the Revenue Act of 1942, *supra*] *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent pro-

vided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * * * *

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

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(26 U. S. C. 1952 ed., Sec. 115.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.115-9. *Distribution in Redemption or Cancellation of Stock Taxable as a Dividend.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and can-

cellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. If a distribution is made pursuant to a corporate resolution reciting that the distribution is made in liquidation of the corporation, and the corporation is completely liquidated and dissolved within one year after the distribution, the distribution will not be considered essentially equivalent to the distribution of a taxable dividend; in all other cases the facts and circumstances should be reported to the Commissioner for his determination whether the distribution, or any part thereof, is essentially equivalent to the distribution of a taxable dividend.

S. Rep. No. 52, 69th Cong., 1st Sess., p. 15 (1939-1 Cum. Bull. (Part 2) 332, 344):

PARTIAL LIQUIDATION

Section 201 (g): It has been contended that under existing law a corporation, especially one which has only a few stockholders, might without resorting to the device of a stock dividend, be able to make a distribution to its stockholders which would have the same effect as a taxable dividend. For example: Assume that two men hold practically all the stock in a corporation, for which each had paid $50,000 in cash, and the corporation had accumulated a surplus of $50,000 above its cash capital. It is claimed that under existing law the corporation could buy from the stockholders, for cash, one-half of the stock held by them and cancel it without making the stockholders subject to any tax. Yet this action, in all essentials, would be the equivalent of a distribution through cash dividends of the earned surplus. The subdivision as rewritten by the House bill is intended to make clear that such a transaction is taxable and the committee approves the provision, which obviously does not apply in cases of complete liquidation of all the stock of the corporation.

The House bill provided that the amendment should be retroactive to January 1, 1925. The committee recommends that the provisions of the 1924 Act in this respect remain in effect during the calendar year 1925 and that the change in the law should become effective only as of January 1, 1926.

Rules of the United States Court of Appeals for the Ninth Circuit:

RULE 10

APPEALS, RETURN AND RECORD

1. In all cases on appeal or review, civil or criminal, the clerk of the trial court or commission shall transmit to the clerk of this court the original files designated by the respective parties as the record on appeal or review.

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RULE 17

PRINTING RECORDS

1. Records shall be printed under the supervision of the clerk of this court. Each party shall pay the estimated expense of printing the portions of the record he designates. * * *

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6. In all cases, including those on petition for review to enforce or to set aside an order of a United States Board or Commission, the appellant or petitioner, upon the filing of the record in this court, shall file with the clerk a concise statement of the points on which he intends to rely. With such statement the appellant or petitioner shall file a designation of all of the record which is material to the consideration of the appeal or review and forthwith serve on the adverse party a copy of the statement and designation. The adverse party, within 10 days thereafter, may designate in writing, filed with the clerk, additional parts of the record which he thinks material; and if he shall not do so, he shall be held to have consented to a hearing on the parts designated. If parts of the record shall be so designated by one or both of the parties, or if such parts be distinctly designated by stipulation of counsel for the respective parties, the clerk shall print those parts only; and the court will consider

nothing but those parts of the record and the points so stated. If at the hearing it shall appear that any material part of the record has not been printed, the appeal may be dismissed, or such other order made as the circumstances may appear to the court to require. If the appellee shall have caused unnecessary parts of the record to be printed, such order as to costs may be made as the court shall think proper.

All statements and stipulations filed hereunder shall distinctly and accurately refer to the pages of the original certified record as well as the documents to be printed or omitted.

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U. S. GOVERNMENT PRINTING OFFICE: 1933

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